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The Durbin Amendment's Interchange Fee and Network Non-Exclusivity Provisions: Did the Federal Reserve Board Overstep its Boundaries?

I. INTRODUCTION

Every time a customer makes a debit card purchase with her debit card, the merchant must pay an interchange fee¹ to the customer's bank as compensation for its role in the transaction.² The Durbin Amendment (Amendment) to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), introduced regulations for debit card interchange fees and transactions.³ The Amendment, which amended the Electronic Fund Transfer Act (EFTA) by adding section 920,⁴ gave the Federal Reserve Board (Board) the task of promulgating regulations that required the debit interchange fee charged by a card issuer to be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction."⁵ It also required the Board to issue regulations prohibiting network exclusivity agreements between card issuers and networks, and required issuers to ensure that each debit transaction can be processed on at least two unaffiliated networks.⁶ These regulations only apply to card issuers that have assets over \$10 billion.⁷ Those with assets below this marker are considered "exempt banks."⁸

1. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(c)(8) (2012) (defining an interchange fee as "any fee established, charged, or received by a payment card network and paid by a merchant or acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction"). For a detailed discussion of interchange fee structures, see *infra* Part II.C.1.

2. See Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (codified at 12 C.F.R. pt. 235).

3. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), § 1075, Pub. L. No. 111-203, 124 Stat. 1376, 2068-2074 (2010).

4. 15 U.S.C. § 1693o-2.

5. *Id.* § 1693o-2(a)(2).

6. *Id.* § 1693o-2(b)(1). See generally *D.C. District Court to Vacate Key Provisions of Regulation II*, ALSTON & BIRD LLP (Aug. 5, 2013), <http://www.alston.com/advisories/nacs-v-board> (providing a brief overview of the Durbin Amendment's major provisions).

7. 15 U.S.C. § 1693o-2(a)(6)(a).

8. *Id.* This Note does not address the provision of the regulation that exempts card issuers with assets less than \$10 billion. However, this Note does discuss how the regulation

The Board's Final Rule (Final Rule) requires that debit interchange fees not exceed twenty-one cents (plus a small ad valorem fee) per transaction.⁹ The Final Rule also requires that a card issuer or network not restrict the number of networks on which a debit transaction may be processed to less than two unaffiliated networks.¹⁰ Some believe that big banks' lobbying efforts during the rulemaking process swayed the Board into creating a Final Rule that was not severe enough to cause changes in the market.¹¹ This criticism culminated in a group of retail trade associations and individual retailers filing suit against the Board to challenge the Final Rule's interchange fee and network non-exclusivity regulations.¹² U.S. District Court Judge Richard J. Leon ruled on July 31, 2013, in *National Association of Convenience Stores v. Board of Governors of the Federal Reserve System*,¹³ that the Final Rule concerning these two provisions of the Amendment was not in accordance with the law under the Administrative Procedure Act (APA).¹⁴ The Court vacated these specific regulations, staying vacatur until further order of the Court, and remanded to the Board to develop new regulations.¹⁵

This Note will examine the effect that the Board's improper interpretation of the interchange fee and network non-exclusivity provisions of the Amendment has had on banks (both exempt and non-exempt), merchants, and consumers. By exceeding its statutory authority, the Board stifled any positive effects that Congress and Senator Durbin believed would have resulted from the Amendment.

has affected big banks and exempt banks differently. For more information regarding this provision, see M. Pierce Sandwith, Note, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Debit Card Interchange Fees and the Durbin Amendment's Small Bank Exemption*, 16 N.C. BANKING INST. 223 (2012).

9. Regulation II, 12 C.F.R. § 235.3(b) (2011) (defining a reasonable and proportional interchange fee as "no more than the sum of twenty-one cents and five basis points multiplied by the value of the transaction").

10. 12 C.F.R. § 235.7(a) (stating that "[a]n issuer or payment card network shall not directly or [indirectly] . . . restrict the number of payment card networks on which an electronic debit transaction may be processed to less than two unaffiliated networks").

11. Tim Chen, *Banks Should Love the Fed's Durbin Amendment Ruling*, FORBES (July 12, 2011, 5:54 PM), <http://www.forbes.com/sites/moneybuilder/2011/07/12/banks-should-love-the-feds-durbin-amendment-ruling/>.

12. *NACS v. Bd. of Governors of the Fed. Reserve Sys.*, No. 11-02075 (RJL), 2013 U.S. Dist. LEXIS 107581, at *3 (D.D.C. July 31, 2013).

13. Throughout this Note, this case is referred to as, "*NACS v. Board*."

14. *NACS*, 2013 U.S. Dist. LEXIS 107581, at *87.

15. *Id.* at *89-92.

Part II will provide a brief overview of the debit card system and its fees.¹⁶ Part III will discuss the legislative history of the Amendment and provide an in-depth discussion of the Board's proposed and final regulations for the interchange fee and network non-exclusivity provisions.¹⁷ Part IV will discuss Judge Leon's analysis in *NACS v. Board*, and explore the intended beneficial effects of the Amendment.¹⁸ Part V will examine the consequences of the Final Rule on big banks, exempt banks, consumers, small and large merchants, and competition among debit networks.¹⁹ Lastly, Part VI will propose a direction for the Board's new final rule if Judge Leon's ruling is upheld.²⁰

II. DEBIT CARD SYSTEM AND INTERCHANGE FEES

A. *Emergence of Noncash Payments and Debit Cards*

When debit cards were introduced in the late 1960s and early 1970s, they allowed consumers to directly access the funds in their deposit accounts from automated teller machines (ATM).²¹ Debit cards have since taken on a new life, allowing depositors to make payments to merchants in stores, online, and even receive cash back at certain locations.²² Debit cards provide many of the traditional benefits of checks, but also provide merchants and consumers with ready access to funds—so that customers can spend more than they might have in their wallet at the time of sale—increase payment efficiency, and reduce fraud and nonpayment risks.²³ Because of the mutual benefits to both consumers and merchants, in recent years debit card use has quickly outpaced check use.²⁴

16. See *infra* Part II.

17. See *infra* Part III.

18. See *infra* Part IV.

19. See *infra* Part V.

20. See *infra* Part VI.

21. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,395 (July 20, 2011) (codified at 12 C.F.R. pt. 235).

22. See *id.* (providing background on the evolution of the noncash payment industry).

23. See IAN LEE ET AL., MACDONALD-LAURIER INSTITUTE, CREDIT WHERE IT'S DUE: HOW PAYMENT CARDS BENEFIT CANADIAN MERCHANTS AND CONSUMERS, AND HOW REGULATION CAN HARM THEM, 2, 12 (2013).

24. *Id.* at 12; see Geoffrey R. Gerdes et al., The 2010 Federal Reserve Payments Study, Fed. Reserve Sys. 4-5 (Apr. 5, 2011), http://www.frb.services.org/files/communications/pdf/press/2010_payments_study.pdf (citing other factors that have contributed to the growth in debit cards such as “technological

B. *The Debit Card System*

A complex process occurs behind the scenes of every debit card transaction.²⁵ There are typically four parties involved in every debit card transaction: a card-issuing bank, card network, merchant acquiring bank, and merchant.²⁶ The card-issuing bank issues a debit card to the consumer and approves or declines purchases that the consumer makes.²⁷ The card network builds and maintains the infrastructure that links all of the parties of the transaction and sets the fees that merchants, card issuers, and acquirers pay.²⁸ The merchant acquiring bank (acquirer) links the merchant to the card network and after approval from the card issuing bank, credits the merchant's account for the sale.²⁹

During a debit card transaction, an electronic authorization request is sent from the merchant to the acquirer.³⁰ The request is sent through a payment network, such as Visa or MasterCard, to the card issuer.³¹ The card issuer then sends a return message confirming that the card is active and that there are sufficient funds in the cardholder's account.³²

An electronic authorization request can be sent over two types

and financial innovations, . . . the business cycle, changes in the composition of economic activity, regulatory developments, and population growth").

25. The system described in this paper is the typical four-party system. There is also a three-party system, which is used for some prepaid card transactions, but is not currently used for typical debit card transactions. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,395.

26. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,394-395; see Fumiko Hayashi, *The New Debit Card Regulations: Initial Effects on Networks and Banks*, ECON. REV. OF THE FED. RESERVE BANK OF KAN. CITY, at 79, 82 (Fourth Quarter 2012) [hereinafter *Initial Effects on Networks and Banks*] (adding an additional party to each transaction: the consumer).

27. See *Initial Effects on Networks and Banks*, *supra* note 26, at 82.

28. *Id.*

29. *Id.*; see Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396.

30. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396 ("An electronic authorization request for a specific dollar amount, along with the cardholder's account information, is sent from the merchant to the acquirer.").

31. *Id.*

32. *Id.* See generally Jason Oxman, *Debit Interchange: A Service Worth Paying For*, AM. BANKER, Sept. 10, 2013 (providing an explanation of the debit card transaction process). There are many networks other than Visa and MasterCard in the market as well. Visa, MasterCard and Discover own the only three signature debit networks in the market. However, there are approximately one dozen PIN debit networks, including three owned by the three signature networks—Interlink, Maestro, and Pulse. *Initial Effects on Networks and Banks*, *supra* note 26, at 82.

of networks: personal identification number (PIN) networks and signature networks.³³ Currently, about 60% of debit card transactions are sent over signature networks, while 40% are sent over PIN networks.³⁴ Many of the leading networks in the industry own both a signature and PIN network.³⁵ PIN networks usually require a PIN from the consumer at the time of the transaction and send authorization and clearance information in one message from the card issuer to the merchant acquirer.³⁶ Conversely, signature networks, which are leveraged on the credit card infrastructure, send two messages from the cardholder's bank: one that contains the authorization information and another that contains the clearing information.³⁷ While PIN transactions instantaneously debit the purchase amount from the cardholder's account, signature transactions typically take two to three days to process and then debit money from the cardholder's account.³⁸ The network over which a transaction is sent depends on a variety of factors such as the transaction type, merchant policy, and features on the consumer's card.³⁹ Most cards support either type of network; however, some transactions, such as hotel reservations, rentals, Internet, and telephone purchases, do not support PIN transactions because the amount due is not known at the time of the purchase.⁴⁰

33. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,395.

34. *Initial Effects on Networks and Banks*, *supra* note 26, at 82.

35. See Fumiko Hayashi, *The New Debit Card Regulations: Effects on Merchants, Consumers, and Payments System Efficiency*, Economic Review of the Federal Reserve Bank of Kansas City, at 90, 92 n.2 (First Quarter 2012) [hereinafter *Effects on Merchants, Consumers, and Payment System Efficiency*].

36. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,395.

37. *Id.*; Arnold S. Rosenberg, *Better than Cash? Global Proliferation of Payment Cards and Consumer Protection Policy*, 44 COLUM. J. TRANSNAT'L. L. 520, 528 (2006).

38. Rosenberg, *supra* note 37, at 528.

39. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,395.

40. *Id.*

C. *Debit and Credit Card Fees*⁴¹

In comparison to a purchase made by check, for which the merchant receives the full face value, when a consumer pays with her debit card, the merchant receives less than the full purchase amount.⁴² This is due to the merchant discount fee, which the acquirer charges the merchant. This fee is made up of smaller fees, including the interchange, network, and processing fees.⁴³ The merchant discount is implicitly dictated by networks because networks establish an interchange fee structure, which is applied to every card-issuing bank in its network.⁴⁴ The card issuer then charges the appropriate rate in the interchange rate structure to the acquirer.⁴⁵ To recoup the interchange fee, the acquirer charges a merchant discount to the merchant to cover this and other fees.⁴⁶ Because of these fees, a merchant typically

41. For an example of debit card fees for a transaction, see *In re Visa Check/MasterMoney Antitrust Litig.*, 192 F.R.D. 68, 72 n.3 (E.D.N.Y. 2000), *aff'd*, 280 F.3d 124 (2nd Cir. 2001) (“Bank A issues a Visa credit card to Consumer X, who purchases a garment for \$100 at Store Y, which was ‘acquired’ for Visa by Bank B. Visa rules mandate that Bank B must pay Bank A an interchange fee of 1.25% of the amount of the transaction, i.e., \$1.25. Bank B will charge Store Y a “discount fee” higher than \$1.25 in order to recover the mandated interchange fee and other fees that Visa rules mandate Bank B to pay Visa on each and every Visa credit card (and debit card) transaction and to earn a profit for itself. Thus, Bank B may charge a discount fee of 1.6% of the transaction amount (or \$1.60) to Store Y. When Store Y presents Consumer X’s \$100 Visa transaction to Bank B, the bank will credit Store Y’s account for \$98.40, send the Visa mandated \$1.25 interchange fee to Bank A and retain \$.35 of the ‘discount fee.’”).

42. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,398 (stating that a payor’s bank in a check system does not recoup the costs it incurs, thus resulting in clearance at par).

43. *Id.* at 43,396 (“The acquirer charges the merchant a merchant discount—the difference between the face value of a transaction and the amount the acquirer transfers to the merchant—that includes the interchange fee, network . . . fees charged to the acquirer, other acquirer costs, and an acquirer markup.”); *Initial Effects on Networks and Banks*, *supra* note 26, at 85 (“[T]he network fee goes to the network that processes the transaction and . . . [the] processing fee goes to the merchant acquirer.”).

44. *See Initial Effects on Networks and Banks*, *supra* note 26, at 85-86; Comment Letter of Senator Richard J. Durbin to Federal Reserve Board 5 (Feb. 22, 2011), *available at* http://www.federalreserve.gov/SECRS/2011/April/20110405/R-1404/R1404_022211_67820_571445654740_1.pdf (presenting a downside to the practice of having one rate structure for each card issuer in the network: that “each bank that issues the network’s cards receives exactly the same network-established fee no matter how efficiently or inefficiently that bank processes transactions or prevents fraud”).

45. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396; *see About Interchange*, ELECTRONIC PAYMENTS COALITION (last visited Feb. 7, 2014), <http://www.electronicpaymentscoalition.org/what-is-interchange/>.

46. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396.

receives approximately 98% of the face value of the transaction.⁴⁷

1. Interchange Fees

Of the many fees associated with debit card transactions, the most lucrative for card issuers is the interchange fee.⁴⁸ An interchange fee is statutorily defined as “any fee established, charged, or received by a payment card network and paid by a merchant or acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction.”⁴⁹ Interchange fee structures are complex, while rates in the structure can vary depending on merchant type and size, and can be either fixed or proportional to the transaction value.⁵⁰ Before the Amendment, networks were incentivized to increase interchange fees continually to attract card issuers to their network because higher fees meant more revenue for the bank.⁵¹ The network also benefited from an increase in card issuers in its network because the more cards issued, the more network fees it could collect.⁵²

While each network creates its own interchange fee structure, fees vary depending on whether the transaction is over a signature or PIN network.⁵³ Before the Amendment, interchange fees averaged twenty-three cents per transaction for PIN transactions and fifty-six cents per transaction for signature transactions.⁵⁴ As a result of this difference, many stores, such as Wal-Mart and Home Depot, began steering customers toward using PIN, while other stores, such as Costco, do not even allow customers to sign for their debit purchases.⁵⁵

47. Richard A. Epstein, *Durbin's Folly: The Erratic Course of Debit Card Markets*, 7 COMPETITION POL'Y INT'L 58, 61 (Autumn 2011).

48. See Comment Letter of Senator Richard J. Durbin to Federal Reserve Board, *supra* note 44, at 5.

49. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(c)(8) (2012).

50. *Initial Effects on Networks and Banks*, *supra* note 26, at 86.

51. Comment Letter of Senator Richard J. Durbin to Federal Reserve Board, *supra* note 44, at 5.

52. See *id.*

53. For an explanation of the differences between PIN and signature networks, see *supra* Part II.B.

54. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,397 (July 20, 2011) (codified at 12 C.F.R. pt. 235) (“The average debit interchange fee for signature debit transactions was . . . 1.53% of the average transaction amount . . . [and t]he average interchange fee for PIN debit transactions was58% of the average transaction amount.”).

55. Andrew Martin, *How Visa, Using Card Fees, Dominates a Market*, N.Y. TIMES

Interchange fees vary widely depending on the authentication method because signature transactions are leveraged on the credit card system, and therefore have interchange fees similar to those for credit card transactions.⁵⁶ Furthermore, PIN fees are lower because the risk of nonpayment is virtually nonexistent.⁵⁷ Both transaction methods' fees continually increased in the years before the Amendment, with PIN debit fees growing at a faster rate.⁵⁸

2. Merchant Discount

In order to use the acquirer's card acceptance services, merchants must pay a merchant discount fee to their acquirer.⁵⁹ A portion of this fee compensates the acquirer for its services, while other portions go to the debit network in the form a network fee and, as previously noted, to the card issuer to cover the interchange fee.⁶⁰ Merchant discount fees come in two forms: interchange-plus and blended.⁶¹ The largest merchants tend to pay an interchange-plus merchant discount, which allows them to pay the exact price for each portion of the merchant discount.⁶² Smaller merchants tend to pay a flat-rate blended fee, irrespective of the exact price of each portion of the merchant discount.⁶³ Merchants with an interchange-plus discount will never pay more than the exact interchange fee for each transaction,

(Jan. 5, 2010), http://www.nytimes.com/2010/01/05/your-money/credit-and-debit-cards/05visa.html?pagewanted=all&_r=1&.

56. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396.

57. *In re Visa Check/MasterMoney Antitrust Litig.*, 280 F.3d 124, 131 (2nd Cir. 2001).

58. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396.

59. *See About Interchange*, *supra* note 45; *Initial Effects on Networks and Banks*, *supra* note 26, at 85 (stating that the processing fee, a component of the merchant discount, goes directly to the merchant acquirer).

60. *Initial Effects on Networks and Banks*, *supra* note 26, at 85.

61. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396 n.17.

62. *See Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 97; David S. Evans et al., *Economic Analysis of Claims in Support of the "Durbin Amendment" to Regulate Debit Card Interchange Fees* 2 n.5 (Visa, Inc., Working Paper 1843628, May 16, 2011), available at SSRN: <http://ssrn.com/abstract=1843628>; *see also* Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396 n.17.

63. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396 n.17; *Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 97. Another explanation for large merchants receiving the interchange-plus fee and smaller merchants receiving the blended fee is that the blended fee allows smaller merchants to simplify their budgeting for debit card transactions while the varying interchange-plus fee would be too burdensome on their budgeting. *See id.*

while those with a blended discount could end up paying more than the transaction's applicable interchange fee, because each portion of the discount is not itemized.⁶⁴ Merchants are able to negotiate with acquirers for which merchant discount they are charged, making bargaining power in the negotiation process critical.⁶⁵ Those merchants with a high volume of sales, and therefore more fee-generating transactions, can negotiate to receive the interchange-plus discount since the acquirer does not want to risk the large merchant walking away.⁶⁶

III. THE DURBIN AMENDMENT

A. Legislative History

As debit card use rapidly increased in the United States, some networks and card issuers entered into exclusivity agreements, "wherein the banks restricted transactions on their debit cards to a single signature network and a single PIN network, which were both owned by the same company."⁶⁷ Senator Richard Durbin pushed for inclusion of the Amendment in the Dodd-Frank Act because these exclusivity agreements were decreasing network competition and creating unreasonably high interchange fees.⁶⁸ Senator Durbin wanted to place

64. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,396 n.17; *Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 97.

65. See David S. Evans et al., *supra* note 62, at 2 n.5 (stating that the merchant acquirer determines the merchant discount fee it will charge a merchant, which signals that there is likely a negotiation process between the two parties).

66. See Scott A. Shay, *Durbin Amendment: The Debit Card Debacle and the Triumph of Mega Retailers*, N.Y. OBSERVER (Sept. 12, 2013, 12:42 PM), <http://observer.com/2013/09/durbin-amendment-the-debit-card-debacle-and-the-triumph-of-the-mega-retailers/> (arguing that the Amendment could have pushed for small businesses "to receive the same prices negotiated and paid by the mega retailers"); Anisha Sekar, *The Durbin Amendment Explained*, NERDWALLET.COM, <http://www.nerdwallet.com/blog/banking/durbin-amendment-explained/> (last updated Sept. 26, 2012) ("Gas stations, small restaurants and small business owners pay the highest fees, while big box retailers like Wal-Mart and Safeway are able to negotiate lower prices.").

67. *Initial Effects on Networks and Banks*, *supra* note 26, at 88. See generally Jim Daly, *Rewriting the Transaction Routing System*, DIGITALTRANSACTIONS.NET (Jan. 1, 2011), <http://www.digitaltransactions.net/news/story/2864> (providing an example of the lucrative nature of exclusivity agreements: "79% of Visa's debit volume from its top ten issuers comes through issuers with whom Visa has exclusive network arrangements").

68. See Comment Letter of Richard J. Durbin to Federal Reserve Board, *supra* note 44, at 5; *Initial Effects on Networks and Banks*, *supra* note 26, at 88. But see *id.* at 79 (stating that opponents to the Amendment argued that "the debit card was already marked by intense

reasonable constraints on debit interchange price-setting and ensure market competition by preventing the ongoing consolidation of the dominant networks' market power.⁶⁹ More precisely, the Amendment had four objectives: (1) helping small, struggling businesses; (2) passing savings on to customers; (3) increasing transparency and competition in the debit interchange fee market; and (4) regulating fees to mirror those throughout the rest of the world.⁷⁰ To accomplish these goals, the Amendment requires that "the amount of any interchange fee that an issuer may receive or charge . . . be reasonable and proportional to the cost incurred by the issuer with respect to the transaction."⁷¹ It also prohibits card issuers and networks from restricting the number of payment networks for a transaction to one network or two or more networks that are "owned, controlled, or otherwise operated by affiliated persons or networks affiliated with such issuer."⁷²

1. Help Small, Struggling Businesses

One of the main objectives of the Amendment was to help small businesses grow, which ideally would help rejuvenate the U.S. economy.⁷³ Many small business owners pushed for this Amendment, offering testimony that increasing interchange fees had eaten away at their profits and left them at the mercy of networks, since merchants must accept debit cards, or risk losing business.⁷⁴ Following the 2008 financial crisis, Congress placed importance on helping these small businesses grow, so that they could hire more workers and increase

competition, aimed not at winning merchants to a given card network but at attracting customers to a given bank's debit cards").

69. Comment Letter of Richard J. Durbin to Federal Reserve Board, *supra* note 44, at 5, 11.

70. See Press Release, Senator Richard J. Durbin, Durbin Statement on His Debit Card Swipe Fee Amendment (May 13, 2010) [hereinafter Durbin Statement on His Debit Card Swipe Fee Amendment], available at <http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=506e66c9-13bd-455c-ba21-d749148b5d5e>; see also Press Release, Senator Richard J. Durbin, Statement by Richard J. Durbin on Swipe Fee Reform (Mar. 16, 2011) [hereinafter Statement by Richard J. Durbin on Swipe Fee Reform], available at <http://www.durbin.senate.gov/public/index.cfm/statementscommentary?ID=4cc823e7-c232-44f2-bfc0-b80b31e2561a>.

71. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(a)(2) (2012).

72. *Id.* § 1693o-2(b)(1)(A).

73. Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70.

74. Statement by Richard J. Durbin on Swipe Fee Reform, *supra* note 70.

sales and profits.⁷⁵ In a perfect world, these businesses' ability to hire more workers would reduce unemployment,⁷⁶ while greater profit margins would inject capital into the market and spur spending—all of which would help a struggling economy. The Amendment also focused on helping small businesses because they did not have the same bargaining power to negotiate for favorable merchant discounts as larger retailers.⁷⁷ The Amendment's provision that mandated interchange fee regulation was intended to level the playing field for these small businesses.⁷⁸

2. Passing Savings to Consumers

Businesses were supposed to pass through savings realized through debit interchange fee regulation on to consumers through lower prices.⁷⁹ When setting prices, merchants generally factor the interchange fee into the sticker price because they do not know in advance whether the customer will choose to pay by cash, check, or card.⁸⁰ Because of these markups, it is estimated the average American family pays an extra \$427 per year for their regular goods and services.⁸¹ The Amendment was supposed to be a method for consumers to realize these savings, keep more of their own money, and for merchants to offer discounts to their customers.⁸²

75. *Id.* For further illustration of the U.S. government's efforts to help small businesses following the 2008 financial crisis, see Small Business Act, 15 U.S.C. § 631 (2012) (citing the policy goals of the Act as aiding, counseling, and assisting with small business concerns, providing assistance to compete in international markets, the use of assistance programs to establish, preserve, and strengthen small business concerns, etc.).

76. See generally UNITED STATES DEPARTMENT OF LABOR, LABOR FORCE STATISTICS FROM THE CURRENT POPULATION SURVEY, <http://data.bls.gov/timeseries/LNS14000000> (citing the United States's unemployment level as 9.5% when the Amendment was passed in July 2010, which was only .5% lower than the highest level since 2003).

77. For an explanation about bargaining power in the relationship between merchants and merchant acquirers, see *supra* Part II.C.2.

78. See Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70 (stating that the Amendment gives small business a chance to fight against the high interchange fees that they are charged).

79. See *id.*

80. See Sekar, *supra* note 66.

81. Press Release, Senator Richard J. Durbin, Durbin Chairs Hearing on the Payment of Interchange Fees by the Federal Government, (June 16, 2010), available at <http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=bf2e545a-27d0-4b8c-9788-7445a91830ae>.

82. See Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70.

Interchange fee regulation would also save the federal government money, since it must pay interchange fees on purchases at federal entities for things like: park admissions and camping fees at the National Park Service; student loan fees at the Department of Education; and insurance copayments from veterans at Veterans' Affairs hospitals.⁸³ For example, in 2009 the City of Chicago and the Illinois Tollway paid \$7.5 million and \$11.6 million, respectively, in interchange fees to card issuers and networks.⁸⁴ The mechanism for paying debit interchange fees is different for government entities than for commercial merchants.⁸⁵ The Treasury pays the card fees for all federal government agencies out of its general fund, so any reduction in card costs would go directly to reducing the Federal deficit.⁸⁶ It was estimated that this regulation would save taxpayers approximately \$36 to \$39 million per year from reduced interchange fees at these government entities.⁸⁷

3. Increase Transparency and Competition

The Amendment was also viewed as a way to stop Visa and MasterCard from holding "all of the cards" in the payment system industry. The interchange fee market is uncompetitive and two-sided, meaning that because there is an interdependent demand between

83. See *Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars: Hearing Before the Subcomm. on Fin. Serv. and Gen. Gov't of the H. Comm. on Appropriation*, 111th Cong. 5-6 (2010) [hereinafter *Oversight of Federal Payment*] (Statement of Gary Grippo, Deputy Assistant Secretary for Fiscal Operations and Policy, Department of Treasury) ("In fiscal year 2009, the Treasury spent \$116 million on interchange and card fees.").

84. Letter from Sen. Richard J. Durbin to Camden Fine, President and CEO of Indep. Cmty. Bankers of Am. and Dan Mica, President and CEO of Credit Union Nat'l Ass'n (June 11, 2010), available at <http://www.durbin.senate.gov/public/index.cfm/pressreleases?id=d9c42bd5-b945-4bee-b025-55aab2fd586a>.

85. See *Oversight of Federal Payment*, *supra* note 83, at 8 (Prepared Statement of Gary Grippo, Deputy Assistant Secretary for Fiscal Operations and Policy, Department of Treasury) ("[I]f a merchant is charged card fees of 2%, a sales transaction of \$100 would result in a deposit of \$98 to the merchant when the card transaction settles, with \$2 withheld to cover the fees. When a Federal agency accepts a card payment for a \$100 transaction with a 2% card fee, however the agency will receive a deposit at par of \$100 and the Treasury will be separately billed for a \$2 fee.").

86. See *id.*

87. *Oversight of Federal Payment*, *supra* note 83, at 3 (Opening Statement of Senator Richard J. Durbin, Chairman).

consumers and merchants for particular cards, the typical supply-and-demand principles that force prices to stay competitive are absent.⁸⁸ Furthermore, the competition that does exist in this market involves networks attempting to attract the banks that issue cards, rather than the consumers and merchants who use them daily.⁸⁹ Through the Amendment, Senator Durbin wanted to increase transparency and competition in the market and break up the Visa/MasterCard duopoly, which at the time represented 80% of the market share in the debit processing network industry.⁹⁰ These companies' dominance over the market was seen as problematic because they unilaterally set interchange fee rates that applied to all banks within their network, without any oversight to ensure that they did not fix these fees at unreasonable levels.⁹¹

The credit card industry received similar criticisms over networks' interchange fee practices for credit card transactions. For example, a 2010 U.S. Department of Justice (DOJ) investigation, in connection with its antitrust settlement with Visa and MasterCard, found that the companies' credit card rules concerning interchange fees were anticompetitive and unfair to consumers and merchants.⁹² Additionally, merchants filed more than fifty lawsuits against credit card networks and their issuers challenging their interchange fee

88. See Lisa Farrell, Note & Comment, *A Step in the Right Direction: Regulation of Debit Card Interchange Fees in the Durbin Amendment*, 15 LEWIS & CLARK L. REV. 1077, 1087–88 (2011) (explaining that a two-sided market “exists when a product’s value is realized only when two seemingly distinct customers both agree to use the product . . . interdependent demand is present . . . [because] consumers will not carry particular cards if merchants do not accept them and merchants will not accept cards if not enough consumers carry them.”). See generally IAN LEE ET AL., *supra* note 23, at 11 (examining pricing methods in two-sided markets).

89. Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70. See generally Martin, *supra* note 55 (discussing Visa’s dominance over the payment system market).

90. See Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70.

91. See *id.*; see also Sekar, *supra* note 66 (claiming that merchants cannot realistically choose not to accept these networks because it would deter business, meaning the networks have enormous power).

92. See Press Release, Department of Justice, Justice Department Sues American Express, MasterCard and Visa to Eliminate Rules Restricting Price Competition; Reaches Settlement with Visa and MasterCard (October 4, 2010), <http://www.justice.gov/opa/pr/2010/October/10-at-1115.html>; Andrew R. Johnson, *Merchants Square Off with Visa, MasterCard over Swipe-Fee Settlement*, WALL ST. J. (Sept. 12, 2013, 10:35 PM), <http://blogs.wsj.com/moneybeat/2013/09/12/merchants-square-off-with-visa-mastercard-over-swipe-fee-settlement/> (asserting that this settlement will be billed as the largest settlement of an anti-trust case in U.S. history).

practices during the 2000s.⁹³ Criticisms of the similarly structured credit card system only furthered support for the regulation of debit card networks.⁹⁴

4. Aligning Interchange Fees with the International Norm

The final, often overlooked, rationale for debit interchange fee regulation was to bring the United States's fee system into conformity with the emerging international norm.⁹⁵ Before the Amendment, debit interchange fees averaged approximately 1.14% of the transaction amount in the United States, while they averaged only 0.2% of the transaction amount in the European Union.⁹⁶ Further, the United States had the highest interchange fees in the world while many other countries were working with Visa and MasterCard to lower their fees.⁹⁷ As early as the 1990s and early 2000s, many countries required interchange fees to be set according to cost-based benchmarks, or even made interchange fees illegal.⁹⁸ It is argued that regulation in at least one country, Australia, resulted in an increased number of transactions, a growth in new debit accounts, and a decrease in cardholder fees.⁹⁹

93. See Terri Bradford & Fumiko Hayashi, *Developments in Interchange Fees in the United States and Abroad*, PAYMENTS SYS. RESEARCH BRIEFING (Federal Reserve Bank of Kansas City, Mo.), Apr. 2008, at 2–4.

94. See *Initial Effects on Networks and Banks*, *supra* note 26, at 88 (stating that the antitrust settlement cited one of the same goals of the Durbin Amendment—creating more competition among debit card networks for merchants).

95. 156 CONG. REC. S10997 (daily ed. Dec. 22, 2010) (statement of Sen. Richard J. Durbin); see Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70. For more information on international trends in interchange fee regulation, see Bradford & Hayashi, *supra* note 93; David A. Balto & Ryan W. Marth, *International Developments on Payment Systems and Interchange Fees*, 61 CONSUMER FIN. L.Q. REP. 121 (2007); Gregory M. Duhl, *International Developments in Consumer Financial Services Law 2007-2008*, 64 BUS. LAW. 677, 679–81 (2009).

96. Press Release, Senator Richard J. Durbin, Durbin, Local Business Owners Call for Prompt Federal Reserve Action on Swipe Fee Regulations (June 10, 2011), available at <http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=31031ccd-2dc6-4045-886f-b7b5b02c1e26>.

97. Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70 (“Visa lowered many European debit rates by 60% while increasing many U.S. debit rates by 30%.”).

98. See Bradford & Hayashi, *supra* note 93, at 2–4 (Canada and Norway impose no interchange fees for debit transactions, Australia and Denmark had required standards and eleven other countries and the European Union had either implemented or proposed credit and debit network regulations).

99. See David Balto, *New Ruling on Swipe Fee Cap; Same Tired Arguments from Bankers*, AM. BANKER, Aug. 16, 2013 (citing the positive effects of interchange fee

The abundance of countries with proposed or implemented interchange rules reflected the global trend toward fee regulation, with the United States noticeably lagging behind.

B. Interchange Fee Provision in the Durbin Amendment

The Amendment requires that “the amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction be *reasonable and proportional* to the cost incurred by the issuer with respect to the transaction.”¹⁰⁰ Congress instructed the Board to implement the statute through regulation.¹⁰¹ The statute states that when creating the rule and deciding on a reasonable and proportional interchange fee, the Board was to distinguish between the incremental costs in the authorization, clearance, or settlement (“ACS”) of a *particular* transaction, and those costs that are *not* specific to a particular transaction.¹⁰² Those costs that were incremental to the ACS of a particular transaction were to be considered when making the fee standard, while non-incremental costs to a particular transaction were not.¹⁰³ In determining which costs to the issuer are incremental to ACS of a particular transaction, the Board requested public comment on a proposed rule for implementing the interchange fee provision of the Amendment.¹⁰⁴

The Board initially proposed an interchange fee regulation on December 28, 2010, providing two alternatives: (1) each card issuer could recover its actual incremental ACS costs up to twelve cents per transaction if the card issuer chose to determine its individual allowable costs, and up to a cap of seven cents if it chose not to (seven-cent cap), or (2) a flat cap of twelve cents per transaction (twelve-cent cap).¹⁰⁵ In

regulation in Australia).

100. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(a)(2) (2012) (emphasis added).

101. *Id.* § 1693o-2(a)(1).

102. *Id.* § 1693o-2(a)(4)(B) (emphasis added).

103. *Id.*

104. See Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,722 (proposed Dec. 28, 2010) (codified at 12 C.F.R. pt. 235) (providing all topics on which the Board requested comment from the public).

105. See Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,726 (referring to these proposals as “Alternative 1” and “Alternative 2,” respectively, during the rulemaking process).

response to the proposed rule, the Board received more than 11,500 comments from card issuers, payment card networks, merchants, consumers, and other interested parties.¹⁰⁶ Generally, merchants supported the seven-cent cap, claiming that it would bring fees in line with those in a competitive, free market.¹⁰⁷ They also claimed that the twelve-cent cap would be too high, based on most card issuers' current actual ACS costs.¹⁰⁸ Card issuers and networks, on the other hand, supported the twelve-cent cap but also suggested expanding the allowable costs to include payment guarantee costs, fraud losses, network processing fees, customer service costs, costs of rewards, and some fixed costs.¹⁰⁹

After analyzing the comments, the Board published its Final Rule on July 20, 2011, which became effective October 1, 2011.¹¹⁰ The Final Rule implemented a modified version of the proposed twelve-cent cap: a fixed cap of twenty-one cents and an ad valorem component of .05% of the transaction's value, plus another penny for issuers that complied with specified fraud prevention measures.¹¹¹ The Board determined the value for the fixed cap based on the per-transaction allowable costs of card issuers at the eightieth percentile.¹¹² The Final Rule also expanded the category of allowable costs that were deemed related to the ACS of a particular transaction, which were therefore factored into the interchange fee cap.¹¹³ The ad valorem component of the Board's final interchange fee standard was also added to account for

106. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,394 (July 20, 2011) (codified at 12 C.F.R. pt. 235).

107. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,402.

108. See *id.*

109. *Id.*

110. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,394.

111. Regulation II, 12 C.F.R. § 235.3(b); see Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,434–35. See generally Consumer Financial Services Group, *The Durbin Amendment – Two Shoes Drop*, BALLARD SPAHR LLP 1 (July 7, 2011), http://www.ballardspahr.com/alertspublications/legalalerts/2011-07_07_the_durbin_amendment_two_shoes_drop.aspx (providing an explanation of the Final Rule).

112. Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,422.

113. See *id.* at 43,404 (“The Board chose to consider network connectivity, software, hardware, equipment, associated labor, networking processing fees, transaction monitoring as incremental, while excluding costs associated with corporate overhead, establishing account relationships, card production and delivery, marketing, research and development, reward programs, customer inquiries, and network membership fees); *Id.* at 43,426–31 (providing an in-depth discussion on the included and excluded costs).

the average per-transaction fraud loss of the median card issuer.¹¹⁴ The Final Rule has been criticized for seemingly bending to the card issuers' and banks' lobbying efforts and favoring these parties more than Congress intended.¹¹⁵

C. *Network Non-Exclusivity Provision in the Durbin Amendment*

The other key provision of the Amendment requires that an issuer or payment card network not "restrict the number of payment card networks on which an electronic debit transaction may be processed to one network, or two or more networks which are owned, controlled, or otherwise operated by affiliated persons or networks affiliated with that issuer."¹¹⁶ In formulating its rule, the Board initially proposed a choice between two alternatives: (A) an issuer or network could not restrict the number of networks over which an electronic debit transaction could be processed to fewer than two unaffiliated networks (network proposal); or (B) an issuer or network could not restrict the number of payment card networks over which a transaction could be processed to fewer than two unaffiliated networks *for each method of authentication* (authentication method proposal).¹¹⁷

Merchants' comments generally supported the authentication method proposal.¹¹⁸ They argued this alternative would create competition within both PIN and signature transactions, which would result in lower transaction fees, better services, and lower prices for goods and services for consumers.¹¹⁹ Conversely, card issuers and

114. *Id.* at 43,422.

115. See Chen, *supra* note 11; Press Release, Senator Richard J. Durbin, Durbin Statement on the Final Federal Reserve Rule on Interchange Fees (June 29, 2011), *available at* <http://www.durbin.senate.gov/public/index.cfm/pressreleases?ID=5a235d89-5db7-4ba8-aca8-c34cb93136f7> [hereinafter Durbin Statement on Final Rule]; Sekar, *supra* note 66 (The "Durbin Amendment is generally seen as more favorable to the financial industry than expected.").

116. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(b)(1)(A) (2012).

117. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,726–27 (proposed Dec. 28, 2010) (emphasis added) ("Under [Alternative A], it would be sufficient for an issuer to issue a debit card that could be processed over one signature-based network and one PIN-based network, provided the networks are not affiliated. . . . Under [Alternative B], an issuer that used both signature- and PIN-based authentication would have to enable its debit cards with two unaffiliated signature-based networks and two unaffiliated PIN-based networks.").

118. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,447.

119. *Id.*

networks supported the network proposal because it would be less disruptive to the existing payment system, as many institutions were already in compliance with that alternative.¹²⁰ These parties further contended that the authentication method proposal would be too costly and burdensome to implement.¹²¹ After considering all comments, the Board adopted the network proposal, believing it to be the most consistent with the statutory language.¹²² Additionally, the Board agreed with the card issuers and networks that the burdens of the authentication method proposal outweighed any benefits to consumers.¹²³

IV. CHALLENGE TO THE FINAL RULE – *NACS v. BOARD OF GOVERNORS*

When the Board announced its Final Rule on June 29, 2011, which was to be published on July 20, 2011,¹²⁴ Senator Durbin released a statement saying that he was disappointed that the Board had succumbed to big banks' pressure during the rulemaking process.¹²⁵ Senator Durbin was not the only person upset with the Board's Final Rule; on November 22, 2011, four major trade associations and two individual retailers brought suit against the Board claiming that it implemented a rule inconsistent with the statute.¹²⁶ In that case, *NACS v. Board*, the Court held that the Board's Final Rule regarding the interchange fees and the network non-exclusivity provisions exceeded the Board's statutory authority.¹²⁷

While reviewing the Board's regulations under the APA, the D.C. District Court applied the two-step analysis developed in *Chevron*

120. *Id.*

121. *Id.*

122. *See id.* (The Board believed that "the plain language of the statute does not require that there be two unaffiliated payment card networks available to the merchant for each method of authentication. In other words, the statute does not expressly require issuers to offer multiple unaffiliated signature and multiple unaffiliated PIN debit card network choices on each card.")

123. *See id.* at 43,448.

124. Press Release, Federal Reserve Board (June 29, 2011), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm>.

125. Durbin Statement on Final Rule, *supra* note 115.

126. *See NACS v. Bd. of Governors of the Fed. Reserve Sys.*, No. 11-02075 (RJL), 2013 U.S. Dist. LEXIS 107581, at *3–4, *30 (D.D.C. July 31, 2013).

127. *Id.* at *2.

*U.S.A., Inc. v. NRDC, Inc.*¹²⁸ to determine whether the Board exceeded its statutory scope in its rulemaking.¹²⁹ Under the first step of the analysis, the Court must decide if the statutory language, coupled with the legislative history, clearly showed Congress's intent with respect to "the precise question at issue."¹³⁰ If the statutory language is unambiguous, then the Board has no power to create rules that go beyond Congress's expressed intent.¹³¹ However, if the Court determines that the statute is silent or ambiguous as to the specific issue, the Board is entitled to clarify any ambiguities through its rulemaking and the Court only invalidates the rule if it were found to be an impermissible construction of the statute.¹³² Under this analysis, Judge Leon determined that the statutory text and Congressional intent regarding the interchange fee and network non-exclusivity provisions were clear, and thus the Board exceeded the scope of its authority in its rulemaking.¹³³

A. *The Board's Interchange Fee Standard is Impermissible*

The District Court held that the Board's Final Rule included allowable costs in its interchange fee standard that Congress did not intend to include, which inflated the interchange fee standard to a level much higher than should have been allowed.¹³⁴ The statute states that

128. 467 U.S. 837 (1984).

129. See *NACS*, 2013 U.S. Dist. LEXIS 107581, at *34.

130. *Id.* at *35 (quoting *Chevron*, 467 U.S. at 842).

131. *Id.* (quoting *Chevron*, 467 U.S. at 842-843). See generally *D.C. District Court to Vacate Key Provisions of Regulation II*, *supra* note 6 (explaining the Court's standard of review and method of analysis).

132. See *NACS*, 2013 U.S. Dist. LEXIS 107581, at *35 ("An agency's construction is permissible 'unless it is arbitrary or capricious in substance or manifestly contrary to the statute.'" (quoting *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 711 (2011))).

133. *Id.* at *45, *82. The Supreme Court developed the *Chevron* doctrine to allow deference to agencies' actions; therefore for this Court to strike down the Board's action under the first step of the analysis shows that the Court felt the agency was overreaching drastically in its rulemaking. See *Chevron*, 467 U.S. at 844.

134. See *NACS*, 2013 U.S. Dist. LEXIS 107581, at *64 ("And it is quite clear that the statute did not allow the Board to consider the additional costs factored into the interchange fee standard."). This is further evidenced by an examination of the Board's proposed rules. The Board initially proposed a \$.07 cap but later implemented a standard over three times that amount. This discrepancy could be used to show that the Board interpreted the statute one way and succumbed to lobbying pressures. See *Debit Card Interchange Fees and Routing*, 76 Fed. Reg. 43,394, 43,401-03 (July 20, 2011) (codified at 12 C.F.R. pt. 235).

the Board is to

distinguish between the incremental costs incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which cost *shall* be considered; and *other* costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs *shall not* be considered

when formulating the interchange fee regulation.¹³⁵ The Court concluded that based on the language “distinguish between,”¹³⁶ Congress intended to bifurcate electronic debit transaction costs into two categories: permissible and impermissible.¹³⁷ Congress’s word choice of “other costs”¹³⁸ also indicated that these two categories were to be mutually exclusive and all encompassing of every cost in the system.¹³⁹ Second, the term “incremental”¹⁴⁰ limited the allowable costs to “variable, as opposed to fixed,” costs in the ACS of a transaction.¹⁴¹ Finally, the term “particular”¹⁴² directed the Board to omit costs that were not unique to a distinct transaction.¹⁴³ Therefore, only costs that were distinct and variable to the ACS of a particular transaction are to be factored into the Board’s interchange fee standard, while all fixed and other costs are to be ignored.¹⁴⁴

The Final Rule, however, did not follow these statutory mandates.¹⁴⁵ The Board included a third category of costs in its interchange fee regulation by factoring in costs that were determined to be specific to a particular transaction, but not incremental to the card

135. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(a)(4)(B) (2012) (emphasis added).

136. *Id.*

137. See NACS, 2013 U.S. Dist. LEXIS 107581, at *44.

138. 15 U.S.C. § 1693o-2(a)(4)(B)(ii).

139. See NACS, 2013 U.S. Dist. LEXIS 107581, at *46.

140. 15 U.S.C. § 1693o-2(a)(4)(B)(i).

141. *Id.* at *51 (quoting *Me. Pub. Serv. Co. v. FERC*, 964 F.2d 5, 9 (D.C. Cir. 1992)).

142. 15 U.S.C. § 1693o-2(a)(4)(B)(ii).

143. See *id.* at *51-52.

144. See *id.* at *44-52.

145. See *id.* at *59.

issuer's role in ACS.¹⁴⁶ The Board improperly narrowed the category of excluded costs to those costs "not incurred in the course of effecting *any* electronic debit transaction,"¹⁴⁷ which expanded the range of allowable costs to "*any* cost that is incurred in the course of effecting an electronic debit transaction."¹⁴⁸ This resulted in the Board factoring into the interchange fee standard costs that Congress did not envision, such as fixed ACS costs, transaction monitoring costs, an allowance for fraud losses, and network processing fees.¹⁴⁹

Legislative history also indicates that Congress intended to bifurcate debit transaction costs into two mutually exclusive categories.¹⁵⁰ Congress passed the Amendment to require reasonable and proportional interchange fee regulations, which would reduce fees for consumers and merchants.¹⁵¹ Congress did not intend for issuers to be able to recoup interchange fees at the level set by the Final Rule because an interchange fee standard set this high would not incentivize competition and innovation of efficient, cost-saving solutions among issuers, as the majority of issuers would be able to recoup all, if not more, of their total operating cost.¹⁵² Despite the Board showing its understanding of Congress's intent in its proposed rule which had much lower caps of seven and twelve-cents,¹⁵³ the Final Rule merely split the

146. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,426 (July 20, 2011) (codified at 12 C.F.R. pt. 235); *see* NACS, 2013 U.S. Dist. LEXIS 107581, at *59.

147. *See* NACS, 2013 U.S. Dist. LEXIS 107581, at *61 (quoting 15 U.S.C. § 1693o-2(a)(4)(B)(ii) (emphasis added)).

148. *See id.* at *61-62 (quoting Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,426).

149. *See id.* at *66.

150. *See* 156 CONG. REC. S5925 (daily ed. July 15, 2010) (statement of Sen. Richard J. Durbin) ("Paragraph (a)(4) makes clear that the cost to be considered by the Board in . . . [its] analysis is the incremental cost incurred by the issuer for its role in the ACS of a particular electronic debit transaction, as opposed to other costs which are not specific to the ACS of a particular electronic debit transaction.").

151. *See* 156 CONG. REC. S5925 (statement of Sen. Richard J. Durbin); *supra* Part III.A.2 (discussing the goals of the Durbin Amendment).

152. *See* Brief of Senator Richard J. Durbin as Amicus Curiae in Support of Plaintiffs' Motion for Summary Judgment at 25, NACS v. Bd. of Governors of the Fed. Reserve Sys., 2013 U.S. Dist. LEXIS 107581 (D.D.C. July 31, 2013) (No. 1:11-cv-02075) ("Congress'[s] goals were to enhance competition, transparency and choice in the debit system and squeeze out inefficiencies by reducing . . . rates . . . thereby compelling large issuers to compete against each other to manage their other costs more efficiently."); Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,422 (stating that the interchange fee standard was at the eightieth percentile of reported interchange costs to card issuers).

153. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,737

difference between merchant and card issuers' desires following the comment period.¹⁵⁴

B. The Board's Network Non-Exclusivity Provision Exceeds Statutory Scope

The District Court also held that the Board exceeded its scope of permissible agency action when it implemented a network non-exclusivity provision that did not follow Congress's express intent.¹⁵⁵ The statute provides:

an issuer or payment card network shall not . . . restrict the number of payment card networks on which an electronic debit *transaction* may be processed to one such network or two or more such networks which are owned, controlled, or otherwise operated by affiliated persons, or networks affiliated with such issuer.¹⁵⁶

The statutory language further "instructs the Board to ensure that issuers and networks [cannot] restrict[] merchants' ability to route each transaction over different networks."¹⁵⁷ After reading the statutory definitions of "electronic debit transaction"¹⁵⁸ and "debit card"¹⁵⁹ into the network non-exclusivity provision, the Court held that Congress expressly "intended for each transaction to be routed over at least two competing networks for each authorization method."¹⁶⁰

Legislative history also indicates that Congress intended the

(proposed Dec. 28, 2010) (codified at 12 C.F.R. pt. 235) ("The Board believes that setting the cap at 12 cents per transaction will be sufficient to allow all but the highest-cost issuers . . . to recover through interchange transaction fees the costs incurred for authorizing, clearing, and settling electronic debit transactions.").

154. Brief of Senator Richard J. Durbin as Amicus Curiae in Support of Plaintiff's Motion for Summary Judgment, *supra* note 152, at 24.

155. See *NACS*, 2013 U.S. Dist. LEXIS 107581, at *81.

156. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(b)(1)(A) (2012) (emphasis added).

157. *NACS*, 2013 U.S. Dist. LEXIS 107581, at *76.

158. 15 U.S.C. § 1693o-2(c)(5) ("The term 'electronic debit transaction' means a transaction in which a person uses a debit card.").

159. *Id.* § 1693o-2(c)(2) ("The term 'debit card' means as any card, or other payment code or device, issued or approved for use through a payment card network to debit an asset account . . . whether authorization is based on signature, PIN, or other means.").

160. *NACS*, 2013 U.S. Dist. LEXIS 107581, at *76-77.

Board to implement a Final Rule that would allow multiple networks for each authentication method (i.e., both PIN and signature networks).¹⁶¹ The Amendment was enacted to combat increasing network fees that were the result of exclusivity deals between networks and card issuers,¹⁶² as well as, to stop the consolidation of market power, to increase competition in the debit network market, and to increase merchant choice.¹⁶³ Senator Durbin stated on the Senate floor that the purpose of the network non-exclusivity provision in the Amendment was to enable each transaction, regardless of whether PIN or signature, “to be run over at least two unaffiliated networks.”¹⁶⁴ Considering both the legislative history and Senator Durbin’s explicit statement, the Board did not carry out Congress’s statutory intent in its rulemaking.¹⁶⁵ The Final Rule effectively barred these goals from being realized because it enacted a regulation with which the majority of networks were already in compliance with, thereby preserving the status quo.¹⁶⁶ As a result of this regulation, most banks’ method of complying with the Final Rule was to “enable more than one PIN network on their debit cards, but not more than one signature network.”¹⁶⁷

161. 156 CONG. REC. S5926 (statement of Sen. Richard J. Durbin).

162. See 156 CONG. REC. S10996 (statement of Sen. Richard J. Durbin) (“In recent years . . . the biggest networks like Visa have begun requiring banks to sign exclusive agreements under which they become the sole network on the banks’ cards. This diminishes competition between networks and leads to higher prices. My amendment will restore this competition.”); *NACS*, 2013 U.S. Dist. LEXIS 107581, at *81.

163. See 156 CONG. REC. S5926 (statement of Sen. Richard J. Durbin); Comment Letter of Senator Richard J. Durbin to Federal Reserve Board, *supra* note 44, at 11.

164. 156 Cong. Rec. S5926 (statement of Sen. Richard J. Durbin) (“This [provision] is intended to enable each and every electronic debit transaction—no matter whether the transaction is authorized by a signature, PIN or otherwise— to be run over at least two unaffiliated networks, and the Board’s regulations should ensure that networks or issuers do not try to evade the intent of this amendment by having cards that may run on only two unaffiliated networks where one of those networks is limited and cannot be used for many types of transactions.”).

165. See *NACS*, 2013 U.S. Dist. LEXIS 107581, at *81.

166. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,447 (July 20, 2011) (codified at 12 C.F.R. pt. 235) (stating that many issuers are in compliance with Alternative A (the “network proposal”), therefore choosing this option would minimize compliance burdens and present less logistical burden).

167. *Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 98.

C. *The Durbin Amendment's Potential Effect with Correct Board Implementation*

Had the Board crafted a Final Rule consistent with Congress's statutory language and legislative history, it is possible that the Amendment would have encouraged economic improvement. The Amendment was enacted to increase competition in the market,¹⁶⁸ which would lower interchange fees for merchants, particularly small merchants.¹⁶⁹ If the increase in competition did decrease fees, then the reasonable and proportional interchange fee cap would have ensured that the fees decreased.¹⁷⁰ The savings from these lower fees for small merchants were supposed to be passed through to consumers, who would in turn increase spending and inject capital into a struggling market (as would the new success of smaller businesses who were no longer crippled by these fees).¹⁷¹ Subsequently, with more money in the market, consumers would have more capital to deposit into banks, which would help reduce any lost fee revenue that the banks might have suffered as a result of the Amendment.¹⁷²

All of the intended benefits were predicated on the understanding that the reduction in prices for consumers would be greater than any cost increase that banks may have passed through to consumers because of lost interchange revenue.¹⁷³ However this was nearly impossible under the Final Rule because it merely cut the interested parties' desires down the middle rather than following Congress's intent.¹⁷⁴ Two years after the implementation of the Durbin

168. 156 CONG. REC. S10996 (statement of Sen. Richard J. Durbin); Comment Letter of Senator Richard J. Durbin to Federal Reserve Board, *supra* note 44, at 11.

169. See discussion *supra* Part III.A.1-2.

170. A decrease in fees was surely to come, because the average interchange fee before regulation was forty-four cents, and the proposed and Final Rule were each less than the previous average. See Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,397.

171. See generally Durbin Statement on His Debit Card Swipe Fee Amendment, *supra* note 70 (arguing the importance of helping small businesses grow as a means for economic improvement).

172. See Sekar, *supra* note 66 ("If [the Board has] correctly judged the cap, banks will not suffer a loss to their bottom line, and will continue to provide the same services to consumers while merchants are able to offer better prices.").

173. See David S. Evans et al., *The Impact of the U.S. Debit Card Interchange Fee Regulation on Consumer Welfare: An Event Study Analysis* 24 (Coase-Sandor Inst. for Law and Econ., Working Paper No. 658) [hereinafter *Impact of U.S. Regulation on Consumer Welfare*].

174. See Brief of Senator Richard J. Durbin as Amicus Curiae in Support of Plaintiff's

Amendment, few of its goals have been fulfilled and instead, many negatives consequences have arisen.

V. CONSEQUENCES OF THE BOARD'S IMPROPER FINAL RULE

A. *The Effect on Big Banks and Exempt Banks*

Under the Board's proposed rule, it was estimated that the average big bank's debit interchange fee revenue would decline by 70 to 80%,¹⁷⁵ and that the rule would cost the industry more than \$6 billion per year.¹⁷⁶ After the Board's regulations became effective on October 1, 2011, sixteen of the top twenty interchange fee-earning banks lost approximately \$1.5 billion in interchange fee revenue in the fourth quarter of 2011 alone.¹⁷⁷ It is estimated that in 2012, the first full year after the regulation went into effect, card issuing banks lost approximately \$7.3 billion in interchange fee revenue.¹⁷⁸ This decrease in revenue is particularly harmful because interchange fee revenue subsidizes many financial institutions' operating costs, such as the cost of offering checking accounts and debit cards, producing cards, and other non-lending products and services.¹⁷⁹

Due to the new regulations, banks supplemented their bottom lines by cutting costs, offering fewer complementary services, and increasing customer fees.¹⁸⁰ Before the Amendment, 76% of banks offered free checking accounts, but by the end of 2012 that number had

Motion for Summary Judgment, *supra* note 152, at 24.

175. Christopher Leonard, *Durbin Amendment Winners, Losers*, AM. BANKER, Feb. 4, 2011.

176. Sekar, *supra* note 66.

177. See Halah Touryalai, *Here Are The Banks That Lost The Most Under The Durbin Amendment*, FORBES (Mar. 29, 2012, 4:52 PM), <http://www.forbes.com/sites/halahtouryalai/2012/03/29/here-are-the-banks-that-lost-the-most-under-the-durbin-amendment/> (The author of this Note performed these calculations using the data from SNL Financial based on the changes between Q3 '11 and Q4 '11 interchange fee revenues.).

178. *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 2.

179. John Buhrmaster, *Losers in Debit Interchange Ruling: Consumers and the Free Market*, AM. BANKER, Aug. 16, 2013.

180. Leonard, *supra* note 175 (Banks are "no longer giving refunds for use of other banks' ATMs, and stopping many services previously included for free on some accounts like free checks, safe deposit box rentals."); *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 47-48 (explaining that most banks pass on about 70% of lost revenue on to consumers, making the pass-through rate of lost revenue higher in the banking sector than in others).

fallen to 39%.¹⁸¹ Additionally, some big banks have either increased the average minimum balance required to avoid maintenance fees or have stopped waiving fees for any account, regardless of the amount held within it.¹⁸² Many big banks have completely dropped debit reward programs to customers and have begun charging for previously complementary services, such as free checks or safety deposit box rentals.¹⁸³ Moreover, many banks had to increase customer fees, including maintenance, overdraft, ATM, and annual fees.¹⁸⁴

Initially, many big banks proposed new monthly fees for debit card transactions to cover lost interchange revenue.¹⁸⁵ For example, Bank of America and Wells Fargo proposed charging a five dollar and three dollar monthly debit card fee, respectively, but these plans triggered immediate customer backlash and neither bank implemented these fees.¹⁸⁶ Because these monthly debit card transaction fees failed, some banks had to increase fees on other services, as previously noted, which likely went unnoticed by many customers.¹⁸⁷ This creates a problem for many customers, particularly those with low incomes, who are frequently driven away from banks because of burdensome hidden or unexpected fees, and must then turn to cash or alternative financial outlets like check-cashing and bill-paying services.¹⁸⁸ It is now harder

181. Claes Bell, *Checking fees rise to record highs in 2012*, BANKRATE.COM (Sept. 24, 2012), <http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx> (stating that free checking accounts fell 6% from 2011 to 2012.).

182. *Id.* (declaring that the average minimum balance required to avoid fees rose 23% from 2011); see also Oxman, *supra* note 32.

183. See Leonard, *supra* note 175; Oxman, *supra* note 32.

184. See Bell, *supra* note 181 (noting that the average monthly maintenance fee for non-interest checking accounts increased 25% from 2011 to \$5.48, overdraft fees have reached a record high of \$31.26, and out-of-network ATM fees increased 11% from 2011).

185. See Robin Sidel, *Big Banks Blink on New Card Fees*, WALL ST. J., Oct. 28, 2011, <http://online.wsj.com/article/SB100014240529702045050304577002041853240850.html> (stating that J.P. Morgan, U.S. Bancorp, Citigroup, PNC, and KeyCorp also suggested these monthly fees on debit transactions but also abandoned that idea); Linette Lopez, *After Dropping Debit Card Fees, Bank of America is Quietly Cranking up Fees Elsewhere*, BUSINESS INSIDER (Nov. 14, 2011, 9:01 AM), <http://www.businessinsider.com/new-fees-banks-are-charging-customers-bank-of-america-debt-card-2011-11>.

186. Dakin Campbell, *Wells Fargo Cancels Pilot Program of \$3 Monthly Debit-Card Fee*, BLOOMBERG (Oct. 28, 2011), <http://www.bloomberg.com/news/2011-10-28/wells-fargo-cancels-pilot-program-of-3-debit-card-fee-as-customers-react.html>; see also Balto, *supra* note 99 (discussing the backlash Bank of America faced when they proposed a \$5 debit card fee).

187. See Lopez, *supra* note 185.

188. See Ann Carrns, *Fees Help Drive Working Poor From Banks*, N.Y. TIMES (Oct. 27,

for these lower-income customers to maintain accounts because of increased fees that are meant to cover lost interchange fee revenue.¹⁸⁹

The backlash from these banks' proposals for monthly debit card transaction fees helped spark support for a grassroots campaign, Bank Transfer Day, which aimed to get people to shift their money out of big banks on November 5, 2011.¹⁹⁰ On that day, approximately 600,000 U.S. customers moved their money from big banks to community banks or credit unions.¹⁹¹ Although this number pales in comparison to the number of checking accounts in the industry, it is meaningful.¹⁹² It takes a great deal of effort for consumers to switch banks, and for so many to do so on a single day shows a deep public resentment towards these fees.¹⁹³

While many exempt banks, which are primarily community banks and credit unions, feared that the Amendment would inadvertently hurt them—because card networks would not be able to set separate interchange fees for regulated and exempt banks—the regulation has actually been to their benefit because nearly all networks have been able to adopt a two-tier fee structure.¹⁹⁴ According to the Kansas City Federal Reserve, exempt banks have barely seen a decrease

2011, 3:22 PM), <http://bucks.blogs.nytimes.com/2011/10/21/fees-drive-working-poor-from-banking-system/>.

189. See IAN LEE ET AL., *supra* note 23, at 16 (“[T]he number of unbanked households rose from approximately 9 million (7.7% of all households) in 2009 to about 10 million (8.8% of all households) in 2010.”).

190. Mitch Lipka, *Personal Finance: Bank Transfer Day saw 600,000 switch*, REUTERS (Jan. 27, 2012), <http://www.reuters.com/article/2012/01/27/us-bank-transfer-idUSTRE80Q1TU20120127>.

191. *Id.*

192. *See id.*

193. *See id.* (“Consumers have strong ties to their banks because of direct deposit, automated bill payments and habit-making change more complex than simply going someplace else.”).

194. *See Initial Effects on Networks and Banks*, *supra* note 26, at 90 (“Many of the smaller, exempt banks had feared that networks, forced by the regulations to lower their interchange fees for the larger, regulated banks, would choose to lower their interchange fees for exempt banks also. However, nearly all debit card networks have set separate interchange fees for regulated banks and exempt banks, creating a two-tier fee structure after the regulations took effect.”); Letter from Sen. Richard J. Durbin, Assistant Majority Leader, to Linda Koch, President and CEO of Ill. Bankers Ass’n, Dan Plauda, President and CEO of Ill. Credit Union League, and Robert Wingert, President of Cmty. Bankers Ass’n of Ill. (Oct. 4, 2011), *available at* <http://www.durbin.senate.gov/public/index.cfm/statementscommentary?ID=a6dbbebe-1af0-427a-abbf-5f3f51d5292b>.

in interchange fee revenue.¹⁹⁵ Exempt banks saw a decrease from forty-five to forty-three cents while those at big banks plummeted from fifty to twenty-four cents.¹⁹⁶ To highlight how the Amendment affects exempt banks differently, Boeing Employees Credit Union (BECU), which recently became subject to the Amendment's regulations due to its assets increasing to over \$10 billion, estimates that lost interchange revenue will cost the bank between \$35 and \$45 million in 2014.¹⁹⁷ In addition to a less drastic change in interchange revenue, these exempt banks have also been able to attract more customers with free checking accounts, lower fees, and new reward programs, which big banks are no longer able to offer.¹⁹⁸

B. The Effect on Consumers, Merchants, and Network Competition

Congress and the Board assumed that merchants would reduce prices when interchange fees became regulated.¹⁹⁹ However, this assumption was baseless because none of the countries in the world that have imposed price controls on interchange fees have experienced any documented pass-through of savings to consumers.²⁰⁰ In Australia, where interchange fees have been regulated for almost a decade, there

195. Kevin Wack, *Damage to Banks from Debit Card Ruling Goes Beyond Lower Fee Cap*, AM. BANKER, Aug. 14, 2013.

196. *Initial Effects on Networks and Banks*, *supra* note 26, at 98-99 (providing the same reduction values for exempt banks and separating regulated banks' decreases by PIN-based and signature-based transactions); Wack, *supra* note 195.

197. David Morrison, *BECU's Durbin Hit: \$45 Million*, CREDIT UNION TIMES (Oct. 2, 2013), <http://www.cutimes.com/2013/10/02/becus-durbin-hit-45-million>.

198. See *Initial Effects on Networks and Banks*, *supra* note 26, at 103 ("Community banks and credit unions have reacted with a range of tactics. Some have offered monthly rewards to prospective customers for opening a checking account. Others have offered cash back for every debit card purchase made by customers during a specified period. Yet others have publicized offers of free checking accounts, with no requirements and no debit card fees."); Bell, *supra* note 181 (stating that 72% of the largest credit unions still offer free checking accounts).

199. See Christine Edwards et al., *Implementing the Durbin Amendment: What was the Fed thinking?*, WINSTON & STRAWN LLP (April 8, 2011), <http://www.lexology.com/library/detail.aspx?g=54df421d-fa3e-4a95-a6ba-f52737d0bb97>.

200. James Kanter, *European Union Advocates Limiting Fees on Debit and Credit Card Transactions*, N.Y. TIMES (July 24, 2013), <http://www.nytimes.com/2013/07/25/business/global/european-union-aims-to-lower-credit-card-fees.html> (quoting Todd J. Zywicki, professor at George Mason University School of Law); see also IAN LEE ET AL., *supra* note 23, at 14-19 (providing a case study on the next effects of interchange fee regulation in the United States and Australia, as evidence for the claim that Canada should forego interchange fee regulation).

has not been any documented evidence of a pass-through of savings to retail consumers.²⁰¹ The United States's experience has been no different: two years after implementation—Congress's assumptions have proven to be wrong, with most consumers having received little to no benefit at all.²⁰²

For the regulation to benefit consumers, savings to consumers from a reduction in retail prices needed to be greater than the amount of lost revenue that banks would pass through to consumers.²⁰³ However, many merchants have not lowered prices and some have even raised them: 81% of stores have raised prices in the past year and many have raised them beyond the rate of inflation.²⁰⁴ Furthermore, any cost savings to merchants because of regulation would likely be too negligible to measure, especially when other merchant costs are changing.²⁰⁵ Merchant prices are also relatively sticky, meaning that prices typically do not reflect any cost reductions for at least one year.²⁰⁶ It is estimated that consumers will lose "\$22 to \$25 billion more per year from higher bank fees and reduced services than they are expected to gain from lower merchant prices and better merchant services."²⁰⁷ Effectively, the initial result of the Amendment was to pad retailers' bottom lines without incentivizing them to reduce prices.²⁰⁸ While there has been a lot of finger pointing in the industry as to who

201. IAN LEE ET AL., *supra* note 23, at 18; see also *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 3–4 ("Reserve Bank of Australia (RBA) . . . claimed that merchants in Australia passed most of the cost savings from reductions in credit card interchange fees on to consumers. The RBA based that conclusion on two false premises: that retailing in Australia is a competitive industry and that economic theory shows that competitive industries pass on most or all of cost savings.").

202. See Press Release, Electronic Payments Coalition, Two Years Later, Consumers Still Not Benefiting from Durbin Amendment (Oct. 1, 2013) [hereinafter Electronic Payments Coalition Press Release], available at <http://finance.yahoo.com/news/two-years-later-consumers-still-173700737.html> (providing that since the Amendment consumers have paid 4.3% more per purchase in stores where prices have increased).

203. *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 24.

204. Electronic Payments Coalition Press Release, *supra* note 202.

205. See IAN LEE ET AL., *supra* note 23, at 16–17.

206. See *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 22.

207. *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 48. *Id.* at 23 ("But [interchange fee regulation's] potential impact on consumer prices is quite small—less than 5 cents on an average transaction even if retailers passed through 100% of the cost savings.").

208. Jeff Horwitz & Harry Terris, *A Year On, Debate About the Durbin Effect Continues*, AM. BANKER, Oct. 1, 2012 (quoting Gil Luria, an analyst at Wedbush Morgan Securities).

has actually been reaping the rewards of reduced interchange fees, it is certainly not the consumer.²⁰⁹

The Amendment has also failed to aid small merchants, the other intended beneficiary of the provision. Before the Amendment, card issuers gave merchants discounts on debit card fees for small purchases.²¹⁰ However, card issuers eliminated this practice in response to their lost interchange revenue, and now many small business owners who sell low-priced goods are paying higher interchange fees.²¹¹ For example, Redbox (which rents DVDs from unmanned kiosks) was forced to raise the price of a daily rental from \$1.00 to \$1.20 in response to higher fees the charged as a result of interchange fee regulation.²¹² Instead, the Amendment has helped big-box retailers who, it has been argued, merely used small merchants as a sympathetic mask and were the real muscle behind the Amendment during the legislative process.²¹³ These big-box retailers, utility companies, hotels, and e-commerce merchants have seen their competitive advantage magnified as the gap between mega retailers and main street shops grows.²¹⁴ If these large merchants truly had the interests of their smaller competitors in mind, they would have pushed for them to have equal bargaining power rather than an interchange fee cap that padded their own bottom line.²¹⁵

The Amendment however did partially realize its objective of

209. See Martha C. White, *Swipe Fee Caps are Here—So Where Are The Savings?*, TIME (May 7, 2012), <http://business.time.com/2012/05/07/swipe-fee-caps-are-here-so-where-are-the-savings/>.

210. See IAN LEE ET AL., *supra* note 23, at 17.

211. See Robin Sidel, *Debit-Fee Cap Has Nasty Side Effect*, WALL ST. J., Dec. 8, 2011, <http://online.wsj.com/article/SB10001424052970204319004577084613307585768.html>; *Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 94. Another explanation for small merchants not benefitting from the regulation is the structure of the blended merchant discount that they are charged. As previously noted, smaller merchants are typically charged a blended merchant discount. This form of merchant discount does not immediately reflect cost savings because the acquirer will not reset the blended fee to reflect new fee reductions until the acquirer can ascertain the distribution of a given merchant's debit transactions between exempt and regulated banks. *Id.* at 97–98.

212. IAN LEE ET AL., *supra* note 23, at 17.

213. See Shay, *supra* note 66; IAN LEE ET AL., *supra* note 23, at 17 n.12 (“In a 2010 Q4 Home Depot Inc. Earnings Conference . . . Home Depot CFO Carol Tomé said, “[o]n the Durbin side . . . [b]ased on the Fed’s draft regulations, we think the benefit to The Home Depot could be \$35 million a year.””).

214. See Shay, *supra* note 66; IAN LEE ET AL., *supra* note 23, at 17; *Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 94 (stating that utility companies, hotels, and e-merchants have realized the greatest savings from the regulation because they had the highest interchange fees before regulation).

215. See Shay, *supra* note 66.

increasing competition in the network market. Before the Board's regulations, Visa's share of the combined signature and PIN debit market was approximately 60%.²¹⁶ After the regulations became effective, Visa's combined PIN and signature card volume decreased for the first time since 2006, and MasterCard's combined PIN and signature card volume was higher in each of the first quarters of 2012 than in corresponding quarters of 2011.²¹⁷ While it is too early to know how competition will shift among the player in the networks' market, the nature of the competition in the market has changed.²¹⁸

PIN network competition has increased because of the method in which most card issuers complied with the network exclusivity regulation—by providing multiple PIN networks but only one signature network on their cards.²¹⁹ For example, Visa's PIN network, Interlink, has lost significant market share to its competitors because many merchants want to avoid Interlink.²²⁰ Because of the network non-exclusivity regulation it is quite likely that PIN transactions are now more evenly distributed among networks, although the same has yet to be reported for signature debit transactions.²²¹

VI. CONCLUSION

In the D.C. District Court's decision in *NACS v. Board*, Judge Leon held that the Board must vacate its interchange fee and network non-exclusivity regulations and develop new regulations that follow Congressional intent.²²² Although the Federal Reserve System has appealed this decision under expedited review by the D.C. Circuit Court of Appeals, the Board's interchange fee and network exclusivity rules

216. *Initial Effects on Networks and Banks*, *supra* note 26, at 82.

217. *Id.* at 103–04.

218. *See id.* at 106.

219. *See Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 98; *Initial Effects on Networks and Banks*, *supra* note 26, at 105.

220. *Effects on Merchants, Consumers, and Payment System Efficiency*, *supra* note 35, at 98 (listing Interlink's competitors as Maestro, Pulse, and Star).

221. *See Initial Effects on Networks and Banks*, *supra* note 26, at 105.

222. *See NACS v. Bd. of Governors of the Fed. Res. Sys.*, No. 11-02075 (RJL), 2013 U.S. Dist. LEXIS 107581, at *86 (D.D.C. July 31, 2013); *Update on D.C. District Court's Determination to Vacate Key Provisions of Regulation II*, ALSTON & BIRD LLP (Aug. 14, 2013), <http://www.alston.com/Files/Publication/9e60f473-8314-4a82-a874-643702c15fc6/Presentation/PublicationAttachment/f929b664-2f04-4606-b919-65c97b1834f5/13-603-Update-on-DC-District-Court.pdf> (explaining the progression of this case).

will stay in place during the appeals process.²²³ Some believe that it is unlikely that the Court's decision will be overturned on appeal because of Judge Leon's strict reading of the statute.²²⁴

Many commentators and lawmakers have advocated for the Amendment to be repealed.²²⁵ However, this is unlikely because the Government Accountability Office has acknowledged the need for interchange regulation²²⁶ and since the Amendment was passed, interchange regulation has continued as the trend in the rest of the world. For example, on September 23, 2013, Visa and MasterCard agreed to a deal with the French Competition Authority to cut their interchange fees in the country by 44% and 49%, respectively.²²⁷ Poland has also passed legislation to limit interchange fees to .5% of a transaction's value.²²⁸ The events in France and Poland reflect the widespread changes in Europe, as the European Commission also wants to cap certain credit and debit card fees in order to stimulate the sluggish economy.²²⁹ Because interchange fee regulation has persisted as the international norm (and due to the negative public sentiment that would arise from a return to an unregulated market), it is very likely that the Board will need to implement new regulations for both of these provisions in the Amendment.²³⁰

223. See Tom Schoenberg and Sara Forden, *Swipe-Fee Rules to Remain in Place During Appeal, Judge Says*, BUSINESSWEEK (Sept. 20, 2013), <http://www.businessweek.com/news/2013-09-20/swipe-fee-rules-to-remain-in-place-during-appeal-judge-says-1>.

224. See Wack, *supra* note 195 (quoting New York University law Professor Richard Epstein); Carolyn Vallejo, *Durbin Debaters Take Sides in Washington*, PYMNTS.COM (Nov. 8, 2013), <http://www.pymnts.com/briefing-room/consumer-engagement/Regulation-Roundup/2013/durbin-debaters-take-sides-in-washington/> (Richard Epstein, a professor at NYU Law, David Balto, a lawyer, and Bob Litan, the Director of Research at Bloomberg Government each agree that the Board's chances on appeal are slim.).

225. See Halah Touryalai, *New Bill Aims to Kill Durbin's Debit Card Fees*, FORBES (Oct. 13, 2011, 2:37 PM), <http://www.forbes.com/sites/halahtouryalai/2011/10/13/new-bill-could-kill-durbins-debit-card-fees/>; Eric Grover, *Congress Should Repeal the Durbin Amendment*, AM. BANKER, Aug. 26, 2013.

226. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-45, RISING INTERCHANGE FEES HAVE INCREASED COSTS FOR MERCHANTS, BUT OPTIONS FOR REDUCING FEES POSE CHALLENGES (2009).

227. Barbara Casaus, *French Agency Renders Decisions to Cut Interbank Fees on Payments*, BNA BANKING REPORT, Oct. 1, 2013.

228. Malgorzata Chrusciak & Ewelina Wagiel, *Poland: Limit on interchange fees for credit and debit cards*, CMS CAMERON MCKENNA, Sept. 26, 2013, <http://www.lexology.com/library/detail.aspx?g=1e5c3fd6-4226-42a1-b969-e50f5ff941b8>.

229. See Kanter, *supra* note 200.

230. But see J. Bradley Jansen, *Stopping the Spread of Bad Ideas*, HUFFINGTONPOST

If Judge Leon's decision is upheld, the Board will likely have to adopt a network non-exclusivity provision similar to its proposed authentication method in order to be in line with the statutory language.²³¹ Judge Leon's analysis regarding the statutory language for this provision of the Amendment indicates that the only way for a network non-exclusivity regulation to be upheld under the APA is for it to allow multiple networks on each card for both PIN and signature transaction.²³² Therefore, the Board's new network non-exclusivity regulation would need to be substantially similar to its authentication method proposal.

For the new interchange fee regulation, the Board could also choose to adopt a regulation that is substantially similar to the proposed rule, or formulate a new standard based on a percentage cap. If the Board were to adopt a new interchange fee regulation that was much lower and in line with the seven or twelve-cent caps that were initially proposed, the new regulation could benefit consumers.²³³ Consumers would benefit because merchants' savings from interchange fee regulation would be large enough to pass savings through to consumers.²³⁴ Furthermore, big banks would likely not be able to increase fees any more than they already have under the existing regulation for fear that consumers would switch to exempt banks that do not need to impose these costs and are able to offer more services.²³⁵ Therefore, under a new regulation that is similar to the Board's proposed rule, consumers would benefit since the pass-through of savings from merchants would likely be greater than the pass-through of

(Nov. 5, 2013, 3:26 PM), http://www.huffingtonpost.com/j-bradley-jansen/stopping-the-spread-of-bad-ideas_b_4213772.html (arguing that based on the failed experiences in Australia and the United States, other countries should not implement interchange fee regulation).

231. See *NACS v. Bd. of Governors of the Fed. Reserve Sys.*, No. 11-02075 (RJL), 2013 U.S. Dist. LEXIS 107581, at *73-86 (D.D.C. July 31, 2013) (Judge Richard J. Leon's analysis of the improper regulation shows that in order to be in line with the statutory language, the Board would need to adopt a regulation similar to Alternative B ("authentication method proposal")).

232. See *NACS*, 2013 U.S. Dist. LEXIS 107581, at *73-87.

233. See generally *Impact of U.S. Regulation on Consumer Welfare*, *supra* note 173, at 24 (providing the theory that consumer savings from retailers must be greater than the pass-through of losses from banks onto consumers in order for interchange fee regulation to be beneficial).

234. See *id.*

235. See Bell, *supra* note 181 (stating that 72% of consumers would consider switching banks if more fees were imposed).

costs from banks.

Another option for the new regulation would be for the Board to adopt a new interchange fee standard based on a percentage cap, as opposed to the flat fee cap that it previously implemented. In its rulemaking, the Board's staff explained that it chose a flat fee cap for the Final Rule because it would incentivize issuers to reduce the costs and administrative burdens of having merchants demonstrate categories of costs associated with rates assessed.²³⁶ However, a percentage cap is arguably more in line with the statutory language, because the statute requires the Board to implement a standard for "reasonable and proportional"²³⁷ interchange fees.²³⁸ Under a percentage cap, the interchange fee charged would be proportional to the cost of the entire transaction. A percentage cap would also be in line with what has emerged as the international norm since the Amendment was passed.²³⁹ Furthermore, it would be consistent with a practice occasionally used prior to the Amendment; debit interchange fees were sometimes a percentage of the purchase price so that banks could make up for losses on small transactions with higher fees on large purchases.²⁴⁰ A percentage cap could also help alleviate some of the negative consequences that arose from the Final Rule, such as the disproportionate effect of higher fees charged to merchants that sell low-priced goods.²⁴¹

236. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,737–38 (proposed Dec. 28, 2010) (codified at 12 C.F.R. pt. 235); *see also* Edwards et al., *supra* note 199.

237. Electronic Fund Transfer Act § 920, 15 U.S.C. § 1693o-2(a)(2) (2012) (emphasis added).

238. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,733 (“[I]n considering whether an interchange fee is proportional to the issuer’s costs, the Board does not believe that proportionality must be interpreted to require identical cost-to-fee ratios for all covered issuers.”). The Board’s construction of the term “proportional” for the interchange fee regulation differed from the commonly accepted definition that the Board previously used to create standards for proportional fees under the Truth in Lending Act, 15 U.S.C. § 1665d (2012).

239. *See* Chrusciak & Wagił, *supra* note 228 (providing that Poland allows a maximum of .5% of a transaction’s value for interchange fees, while the European Commission is considering .2% of the transaction’s value for debit cards and .3% for debit cards).

240. *See* Epstein, *supra* note 47, at 59.

241. Networks would not need to eliminate the discounts for merchants that sell low-priced goods, as they did after the implementation of the interchange fee regulation, because the networks would be able to recoup any losses from these discounts with the proportional interchange fee revenue from large purchases. *See generally* IAN LEE ET AL., *supra* note 23, at 17.

At this time, no one in the payment system industry is sure what will happen on appeal or how the Board will construct its Final Rule if Judge Leon's ruling is upheld. If the Board does not seriously reconsider its Rule, the negative consequences to the banking industry and consumers will only be amplified, and America will continue to be increasingly dominated by big box retailers while main street businesses will continue to disappear.

KATHLEEN A. MCCONNELL

